

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B02
PLR-144268-13
Date:
December 03, 2013

Legend

X =

Trust =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

A =

n =

o =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Dear _____ :

This responds to a letter dated June 20, 2013, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was formed in State in Date 1 and later elected to be treated as an S corporation. X's sole shareholder was A, an individual. A died on Date 2. The executor of A's estate distributed all X shares to Trust on Date 4. X represents that Trust satisfies the requirements to be a qualified sub-chapter S trust ("QSST") within the meaning of § 1361(d) effective Date. However, the sole beneficiary of Trust did not make a timely QSST election under § 1361(d)(2). Therefore, Trust was not a permissible shareholder on Date 4 and thereafter.

Additionally, at the close of three consecutive taxable years ending Year 3, X had subchapter C accumulated earnings and profits (AE&P) of approximately \$n. Moreover, for each taxable year ending Year 1, Year 2, and Year 3, X had passive investment income (within the meaning of § 1362(d)(3)) in excess of 25 percent of its gross receipts. As a result, X's S election terminated on Date 3.

X represents that X and each of its shareholders have filed consistently with the treatment of X as an S corporation for all relevant tax years. X further represents that the termination was not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of X as an S corporation.

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1362(d)(3)(A)(i) provides that an election under § 1362(a) shall be terminated whenever the corporation has accumulated earnings and profits at the close of each of three consecutive taxable years, and has gross receipts for each of the taxable years more than 25% of which are passive investment income.

Section 1362(d)(3)(A)(ii) provides that the termination under § 1362(d)(3) shall be effective on and after the first date of the first tax year beginning after the third consecutive taxable year referred to in § 1362(d)(3)(A)(i).

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such

termination, steps were taken so that the corporation for which the termination occurred is a small business corporation, and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to 1362(f), agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1375(a) provides that if an S corporation has accumulated earnings and profits at the close of a taxable year and gross receipts for that taxable year more than 25 percent of which are passive investment income, then there is imposed a tax on the income of such corporation for such taxable year. Such tax shall be computed by multiplying the excess net passive income by the highest rate of tax specified in § 11(b).

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated on Date 3, under § 1362(d)(3)(A), because X had AE&P at the close of each of three consecutive tax years, Year 1, Year 2, and Year 3, and had gross receipts for each of those years of which more than 25% of which were passive investment income. We further conclude that the termination was inadvertent within the meaning of § 1362(f).

We conclude that X's election to be treated as an S corporation would have also terminated on Date 4 because Trust was not an eligible shareholder of X. We conclude that this termination, had it not already terminated on Date 3 was inadvertent within the meaning of § 1362(f). We further conclude that, pursuant to the provisions of § 1362(f), X will continue to be treated as being an S corporation from Date 3 and thereafter, provided that X is otherwise eligible to be an S corporation and provided that the election was not otherwise terminated under § 1362(d).

Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation beginning on Date 3, and thereafter, provided that X's S corporation election was valid and has not otherwise terminated under § 1362(d) and the following conditions are met. This ruling is conditioned upon Trust's beneficiary filing a QSST election for Trust, with an effective date of Date 3 within 120 days of the date of this ruling. A copy of this letter should be attached to the election. Additionally, within 120 days from the date of this letter, X shall file an amended income tax return for its Year 4 tax year, electing pursuant to § 1.1368-1(f)(3) to make a deemed dividend of its AE&P. Also, within 120 days, the Year 4 income tax return(s) of the shareholders of X must be amended to reflect the changes made to X's Year 4 tax return. No amendments shall be made to X's income tax returns for the taxable years ending Year 1 and Year 2 with respect to the tax imposed under § 1375. However, as an adjustment under § 1362(f)(4), X must send payment of \$0 with a copy of this letter to the following address:

Internal Revenue Service

Manual Deposit

X must send this payment no later than 45 days from the date of this letter. If all the above conditions are not met, then this ruling is null and void. Furthermore, if these conditions are not met, X must send notification that its S election has terminated to the service center with which X's S election was filed.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code. Specifically, we express no opinion regarding X's eligibility to be an S corporation.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Bradford Poston
Senior Counsel, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

cc: